

ANALYSIS OF AMENDED BILL

Franchise Tax Board

Author: Margett Analyst: Darrine Distefano Bill Number: SB 1121

Related Bills: See Legislative History Telephone: 845-6458 Amended Date: 04-03-2001

Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Employer Work Opportunity Credit/Wages Paid to Individuals Qualified for State Disability

SUMMARY

This bill will allow a credit to employers that pay wages to individuals who qualify for state disability insurance (SDI).

This analysis will not address the bill's provisions regarding unemployment insurance since those provisions do not impact the department's programs or operations.

SUMMARY OF AMENDMENTS

The April 3, 2001, amendments added an operative date so that the credit will apply to taxable years beginning on or after January 1, 2001.

The April 3, 2001, amendments also changed some of the bill's provisions regarding unemployment insurance.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

The author's staff has indicated that the purpose of this bill is to encourage employers to hire individuals who are currently receiving SDI disability compensation.

EFFECTIVE/OPERATIVE DATE

This bill would be effective January 1, 2002, and would apply to taxable years beginning on or after that date.

POSITION

Pending.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

06/18/01

ANALYSIS

FEDERAL/STATE LAW

Federal law provides special tax incentives designed to encourage employers to hire or train specified individuals, usually the unemployed or those in need of additional training. Federal programs include the federal Vocational Education Act of 1963, Workforce Investment Act of 1998, and the Greater Avenues for Independence Act of 1985 (GAIN) Program. California law refers to these federal programs in describing individuals qualified to participate in certain state programs and tax credits.

Federal law allows a Work Opportunity Tax Credit (WOTC). The credit is 40% of the qualified first year wages. WOTC provides a credit to employers who hire AFDC recipients, veterans, ex-felons, high-risk youths, vocational rehabilitation referrals, summer youth employees, food stamp recipients, and SSI recipients.

The "qualified first year wages " are wages paid for services beginning with the day the individual begins work for the employer. The amount of qualified first-year wages may not exceed \$6,000 per year.

The federal credit currently applies to wages paid to individuals who begin work for the employer before December 31, 1994 and on or after October 1, 1996, and no later than December 31, 2001.

Existing state law authorizes hiring tax credits, as well as other business tax incentives, which are intended to encourage business expansion and hiring in economic development areas, including Enterprise Zones, Targeted Tax Areas, Manufacturing Enhancement Areas, and Local Agency Military Base Recovery Areas.

Existing state and federal laws allow a deduction for business expenses, including employee salaries.

SDI allows employees to receive a weekly benefit amount when any mental or physical illness or injury prevents them from performing their regular or customary work. The SDI Fund, created under the Unemployment Insurance Code, is funded by contributions withheld from the first \$46,327 in wages paid to each covered employee in California. Employers are required to withhold the disability insurance contributions from the wages of each employee up to the taxable wage limits and remit the funds to the Employment Development Department (EDD) quarterly.

State law specifies that any excess SDI contribution shall be credited against income tax and applied to the year the excess contribution occurred. Any overpayment of taxes may be refunded. Denial of the credit can be appealed to EDD.

THIS BILL

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL) this bill would create a state credit that is similar to WOTC. The WOTC allows employers who hire members of a targeted group to claim a 40% credit of the first year wages (up to \$6,000 per employee), for a maximum credit of \$2,400.

This bill would define the term "members of a targeted group" to mean only those individuals who qualify for SDI in California.

IMPLEMENTATION CONSIDERATIONS

This bill adopts the federal credit by reference. When conforming to federal law by reference, the incorporation of federal law is as of January 1, 1998. On January 1, 1998, federal law applied only to wages paid to individuals that had been hired before 1994 and between October 2, 1996, and June 30, 1998. Although, the amendment added an effective date of January 1, 2001, the credit would not be applicable to any employees who are hired on or after January 1, 2002. The author may wish to modify the federal termination date for state purposes, and also specify the version of the federal law (Internal Revenue Code as of a particular date) that the author intends to apply in determining the credit provided under this bill.

Also, this bill uses the term “individuals who are qualified” for SDI. According to the author’s staff, the credit is to encourage employers to hire individuals who are currently receiving disability compensation. The language of the bill implies that all employers would be eligible for the credit on all of their employees. If the author’s intent is to encourage employers to hire the same types of employees that qualify for WOTC, with an additional limitation that the employee must be receiving disability compensation under California SDI, the author may want to revise the bill to clearly define the types of individuals who will qualify under this credit.

LEGISLATIVE HISTORY

AB 489 (Ducheny, 1999/2000) failed to pass out of the first house. This bill would have allowed employers a tax credit for unemployment insurance taxes and employment training taxes on tips. AB 203 (Washington, 1999/2000) died in the Senate Public Safety Committee. This bill would have allowed employers a credit equal to one-third of the wages paid during the first year of employment of a qualified at-risk youth. The credit would be limited to \$5,000 per youth. Additionally, this bill would have allowed employers a credit for the services of a county probation or parole officer, not to exceed \$300 for each at-risk youth.

OTHER STATES’ INFORMATION

Review of *Florida, Illinois, Michigan, and New York* laws found no comparable tax credits or deductions.

Massachusetts allows a Full Employment Credit (FEC) to qualified employers who continue to employ a participant of the FEC program. The credit is \$100 per month of eligible employment per participant.

These states were reviewed because of the similarities between California income tax laws and their tax laws.

FISCAL IMPACT

Once the implementation concerns are resolved, this bill would not significantly impact the department’s costs.

ECONOMIC IMPACT

Fiscal Year Cash Flow Taxable Years Beginning After December 31, 2000 Enactment Assumed After June 30, 2001 \$ Millions		
2001-02	2002-03	2003-04
-\$9	-\$5	-\$2

Note: The federal credit, under Section 51, is effective for wages paid or incurred before December 31, 2001, and will sunset thereafter. According to the amendment, the effective date would be for wages paid or incurred in 2001. Therefore, this bill, as amended, would only have a one-year impact. The fiscal year 2001-02 includes this impact and the out-years reflect carryover credits.

Revenue Discussion

The revenue impact for this bill will depend upon the number of state disability recipients, amount of wages paid, and amount of available tax liabilities of qualified employers.

This estimate was developed in the following steps. First, according to the Employment Development Department (EDD), it is estimated that approximately 642,700 individuals would qualify and receive disability income for tax year 2001. This number was adjusted downward to reflect those individuals who would not enter the workforce, leaving 578,000 qualified individuals. Second, it was assumed that approximately 5% of qualified individuals, or 28,900, would enter the force in any given year and qualify their employer for the tax credit. It was further assumed that approximately one-third of these individuals would qualify for tax year 2001 because of various hiring dates and the length of time on disability, leaving 9,500 qualified individuals for tax year 2001. Third, based on discussions with EDD, the majority of individuals receiving disability income generally make higher wages. Therefore, the maximum credit amount of \$2,400 as stated in the bill ($6,000 \times .40\%$) was used. Multiplying these elements, the total credit amount generated for tax year 2001 is projected to be approximately \$23 million. It was assumed that 75% of generated credits would be applied against tax liabilities over the initial three fiscal years in the pattern shown above.

POLICY CONCERNS

This bill does not specify a repeal date or limit the number of years for the carryover period. Credits typically are enacted with a repeal date to allow the Legislature to review their effectiveness. However, even if a repeal date were added, the department would be required to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

This bill provides a state credit equal to the federal credit. In general, a taxpayer's federal income tax liability is significantly higher than his or her state income tax liability. As a result, a state tax credit equal in amount to a federal credit could be considered to provide a greater proportionate benefit for state tax purposes than for federal tax purposes. The author may wish to amend this credit to be a percentage of the federal credit, perhaps in an approximate relationship to the highest federal marginal rate to the highest state marginal rate.

This bill would allow taxpayers located within an enterprise zone to claim both this credit and the enterprise zone hiring credit based on the same wages. The enterprise zone credit provisions do not restrict the taxpayer to one credit based upon a single employee. By allowing the taxpayer to claim the proposed credit in addition to any deduction or credit allowed for the same expenses, this bill would allow taxpayers to claim multiple tax benefits for the same item of expense in excess of the taxpayer's actual economic investment.

This bill would create differences between federal and California tax law, thereby increasing the complexity of California tax return preparation.

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